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Introduction

Y ou’ll come into contact with money almost every day for the rest of your life. When you’re at work, you’re earning money; when you’re at the mall, you’re spending money. Used poorly, money can be a source of anxiety and lead to financial problems. Used wisely, money can be a tool to help you achieve your goals and dreams. That’s the goal of the NEFE High School Financial Planning Program, to help you learn how to responsibly and effectively manage your money for the rest of your life.

The NEFE High School Financial Planning Program has three main objectives. For you to:

1. learn the financial planning process—what it is and what it can do for you;
2. apply the process through assignments you will complete that relate to your experiences with money; and,
3. take control of your financial affairs, starting today.

This graphic will remind you of the three main objectives of the program.

Overview.

This overview presents the scope and relationships of the main points of the unit. In the Can You Believe? section in each unit you’ll discover interesting facts and trivia related to teens and money. Key Words are shown in boldface type and shaded. Learning Icons are also included. Learning Icons highlight important concepts in each unit.

Throughout each unit you will also see Assignment Icons. When you see the Assignment Icon, you’ll know what to do with what you’ve learned immediately into practice.

Assignment

Each unit in the program deals with a specific area of financial planning. The topics you will cover, along with the activities and assignments, will help you understand how to make the most of your money in that area. A list of some of the main topics include:

- goal setting and decision making;
- financial planning;
- careers;
- a personal budget;
- smart shopping;
- saving and investing;
- using credit and credit cards wisely;
- how debt affects you; and,
- keeping auto insurance costs down.

Effectively managing money and finances is a learned skill. Without training and education, you can probably “get by” with your money for the rest of your life. Maybe you’ll make it financially; maybe you won’t.

But with the knowledge and skill you’ll gain from the NEFE High School Financial Planning Program, you can be in control of your finances and well on your way to a lifetime of financial security, while achieving the personal goals and dreams that are important to you.

You’re at the perfect stage in your life to learn to take control of your money. Take the NEFE challenge and begin now!

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Andrea knows what she wants. At age 13, she already has her eye on a brand new, red pickup truck when she turns 16 and gets her driver's license. At age 17, Matt is thinking about his first year of college. His parents haven't saved up much money for college expenses, so Matt will try to save most of his paycheck from his summer job as a road worker.

Jesse, age 16, just spent four months' worth of his part-time job pay on a CD burner for his computer. He's been quite popular lately, since he can make custom music CDs for all his friends.

What do these students all have in common? They're making use of money. And whether they realize it or not, they're all using some type of plan to meet their personal goals. That's what this unit is all about: how to make your money meet your goals. If you mention this idea to your parents, you might hear them call it "financial planning," so we'll do the same.

Some questions you will be able to answer by the end of this unit are:

- What are the five steps in the personal financial planning process?
- How do you set "SMART" goals?
- How do your choices affect your money?

**Overview: What is Financial Planning?**

When carpenters start framing a house, they follow a simple rule: "plan your work; work your plan." You can imagine what would happen if they just started hammering boards together and raising walls without a plan. Not the kind of house most people would want to live in for any length of time.

Personal financial planning is the process of defining goals, developing a plan to achieve them, and putting the plan into action. It is the blueprint of planning for handling all aspects of your money, including spending, credit, saving, and investing. Some people plan well and have the rewards that go with it—nicer cars, comfortable homes, savings, fun vacation trips. Other people never learn to plan, and never seem to have enough money, instead living paycheck to paycheck all their lives.

So why this difference, and what are the elements of a good financial plan? Look at the graphic that follows.

**"Most people don't plan to fail. They simply fail to plan."**

**How can money help you live a satisfying life?**

A good financial plan distinguishes between needs and wants.

**Needs Versus Wants**

Needs are essentials, the basics of life. Think food, clothing, and a place to live, etc. Wants simply increase the quality of living. Going to movies, eating out, and cruising on Friday nights (which costs gas money) are wants. These are all fun and interesting to do, but your life wouldn't be all that different tomorrow if you couldn't go to the movies tonight. There's nothing wrong with wants, but for most people with limited amounts of money, needs get taken care of first.

In the center column in Assignment 1.1, list five items or activities that cost money. Then take a look at each item and put a check mark in the Need or Want column as you see fit.

Compare your answers with some of your classmates. Is there a difference between your needs and theirs? What about your wants?

People define needs and wants differently (and that's okay!), depending on their own values. Your values are simply the beliefs and practices in your life that are very important to you. Lots of things may influence your values, such as your family, your friends, your teachers, your church, or your work.

**Some Examples of Values.**

- Earning good grades.
- Being responsible with money.
- Being on time for work.
- Telling the truth.
- Spending time with people you love.

**Assignment 1.1**

My Needs and Wants: Can I Tell the Difference?

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And whether you realize it consciously or not, you do have a set of values. Some of those values relate to money, like having a good credit record. The more aware of your values you are, the easier it is to set goals that will make your life satisfying. To help you identify your personal financial values, fill out Assignment 1.2.

One way of mapping your future is by understanding and implementing your goals.

Setting Goals

A goal is a destination, something you want or need, which you acquire by taking certain steps. It gives direction to your plan of action. One of the most valuable things you can learn to do is to identify your goals clearly. Your goal might be to travel to Florida over Spring Break. You may have a goal to install a new equalizer in your car’s sound system. Or it might be to buy a new coat because your old one is too small.

To be really effective, goals should always be in writing and should be meaningful to you. Your friend’s goals might be really cool, but they won’t mean as much to you as your own goals, which are based on your values. It’s helpful to define your goals in a “SMART” way. Think of it like this:

Specific: “I want to spend my entire Spring Break at Daytona Beach.” Not “I want to do something fun over Spring Break.”

Measurable: “I need $120 for my share of the gas, hotel room, and food for the week.” Not “I need some money for my trip.”

Attainable: “I’ll save $15 a week from Thanksgiving until Spring Break.” Not “I’ll win a weekly radio call-in contest to get the money to pay for my trip.”

Realistic: “I plan to drive from Omaha to Daytona in about 24 hours by using four drivers.” Not “I want to drive from Omaha to Daytona in about half a day.”

Time-bound: “I’ll have the $200 for my trip expenses saved up by March 5th.” Not “I want to save up enough money by early spring.”

Think of your goals as what you want to be, do, or have—either in other words, where you want to go. Remember, part of setting SMART goals means they are realistic and attainable. It’s very helpful to break up your goals into three time periods for planning purposes.

Sample SMART Goal Timelines.

Short-term: to save $25 by the 1st of next month so I can take my friend out for pizza and a movie.

Intermediate-term: to save $10 a week for the next 25 weeks to buy a new outfit for the prom.

Long-term: to save $2,000 per year from summer jobs for the next four years for a down payment on a new car.

Timelines for Goals

Short-term goals have a time frame of up to three months. Intermediate-term goals take place between three months and one year. And long-term goals are out more than a year. Those long-term goals require patience to achieve and a willingness to give up something you want now in return for something better later. This is known as delayed gratification. For example, a person can buy a new shirt now on credit—and possibly pay more for it—or save the money to pay cash for it later. With the national savings rate close to zero, many people are apparently choosing instant gratification instead of waiting!

Using Assignment 1.3, write down some of your own goals. Remember to make them look SMART!

If you’re like most people, you may have noticed that the total of all of your goals takes more money than you can set aside each week. Don’t puzzle over that too long for now. We’ll talk about how to handle that problem later.

For example, a short-term goal might be to get a new jacket. Answers to questions like these help pinpoint where you are today financially. It matters because your financial resources (the things you own and the money you earn or receive) have a direct impact on your goals.

To help you analyze these questions, you can track your cash flow with a Personal Spending Record. Cash flow is simply a measure of the money you receive and the money you spend. We’ll talk a lot more about cash flow in Unit 3. How you manage cash flow has a direct impact on your goals.

To help you get a handle on where your financial resources are now, complete the Personal Spending Record that follows. In a notebook or on a piece of paper, use the form in Assignment 1.4 as a model to track your money for the next several weeks.

We’ll make use of this information later in Unit 3, but for now, try to fill in the table for the last seven days. If you can’t remember every dollar you spent or received, that’s okay; just do the best you can.

But, keep track on a daily basis.

Now that you have some idea of where you are (your financial resources) and where you want to go (your goals), the trick is figuring out how to get there. To do that, move on to the next step.

Step Three: Create a Plan

Look back at the goals you listed in the “My SMART Goals” table. How much is the weekly dollar amount you need to save? (Assignment 1.3)

Next look at your Personal Spending Record for the last week. How much money, if any, did you have left over at the end of the week? (Assignment 1.4)

If you do have money left over, then you’re ahead of the game and ready to start meeting those goals. But if you’re like most people, your “leftover” money isn’t nearly enough to cover what you need to save for your goals. You have limited resources. So what do you do? Time to make some financial decisions and formulate a plan...Decision making is the process of considering and analyzing information in order to make a decision.

Making Decisions

Let’s say you have two goals you want to meet. Here are the two goals:

Goal A: to save $4 per week for the next four weeks to buy a music CD.

Goal B: to save $10 per week for the next six weeks to buy a pair of shoes.

By the way, ideally your total for column A will be bigger than B—if you practice delayed gratification.
On the average, your Personal Spending Record shows you have only $5 left each week. Do you choose Goal A or B?

If you go for the CD (Goal A), you can definitely meet it in four weeks. In fact, you’ll have $1 left over each week to put towards another goal. But if you choose the CD, you basically give up any hope of buying shoes in the near future.

On the other hand, you could put all your money toward Goal B (shoes). You don’t have enough to meet the weekly dollar goal, so it would actually take you 12 weeks to save up the $60—that’s delayed gratification. But you would make it eventually. Of course, if you save all of your money for shoes, then you’ve eliminated any hope of buying that CD.

A third option would be to split your spending between the two goals (say $2 for the CD and $3 for the shoes). In this case, you’d need a lot more time to meet both goals, but at least you’d be working towards both.

Another option would be to either increase your income (ask for a raise or less hours on your job) or to decrease your expenses. The route works really well for some people, and we will talk more about it in a later unit. But for now, let’s stay focused on your goals.

To help you choose, write down all the reasons for or against each option. We’ll call it a “pros & cons” decision chart. Look at the example that begins this process below.

In our example of the CD and shoes, choosing the CD means delaying the purchase. We give up the opportunity of getting those shoes in six weeks. Think of it this way. When you spend cash on a hamburger, fries and a shake, you can’t put that money towards gas for your car. Choosing “fuel” for your stomach means giving up fuel for your car.

Which is worse, an empty stomach or an empty gas tank? Who knows? Only you can decide. But with limited resources, you can’t do it all.

The opportunity cost of buying fast food means no gas for your car. So you make choices and realize you’re giving up certain goals or opportunities as well. And that’s okay, because that’s how most people live.

Below is a blank “pros & cons” chart (Assignment 1.5) you can complete to help you think through your choices. Try to think about each decision from as many different points of view as you can. It’s okay to ask other people, like your friends, teachers, and parents, for their input as well.

Pros Cons
1. Fully meet the need for Goal A (4x/week)
2. Can only put $1/week toward Goal B
3. Have $1 left over each week for other uses
4. Big delay in getting those Shoes

Your way of thinking—there may be more pros than cons, or the opposite may be true. Often there is no “right” answer. Instead, you have to make decisions based on the values you listed in an earlier exercise and accept the tradeoffs.

Most people don’t like making tradeoffs. It’s tough! Choosing one option may mean giving up altogether on another goal. In economic terms, this is called opportunity cost.

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There's an old saying that goes, "Since you're going to be working for the rest of your life, you might as well do something you really enjoy." Ideally, you'd like to find work you love to do and that pays you enough to live comfortably. Sadly, many working adults find themselves doing work that is not challenging and doesn't pay well. The good news is, with the right career choices, you don't have to follow that unhappy pattern. You can consciously begin to choose the career you want. You have the advantage of time and the opportunity to choose. After high school you might go directly into a job, enter a training program, or go to college. Your future is just beginning to unfold, and the choices about work are yours to make.

Some of the questions you will be able to answer by the end of this unit are:

**How does the career you choose affect your income?**

**What employee characteristics are important to an employer?**

**How do education and training affect your salary?**

**What is an entrepreneur?**

**What are employee benefits?**

**Work and Money**

One of your single greatest assets is the earning power from your chosen career and/or your talents and skills. Many people think a house is the most valuable thing they'll ever own, but a lifetime of earnings is usually worth much more than a house. How much you earn in a lifetime can be affected by your choices about education, training, where you live, and for whom you work. We'll look at all of these factors in this unit, and then give you some ideas about how to make the most of your working life.

**Your Career**

What is the difference between a job and a career? It usually comes down to attitude. A job is relatively short-term work that "pays the bills." A career is usually a long-term chosen profession or occupation that provides an income. Often there is a planned sequence of jobs as you build a career. Think of it this way: in high school your "career" is being a student. In just four years of school, you take a lot of different classes (jobs). Some of these classes you love, some you endure. But ultimately you achieve your career goal as a student and graduate.

Now think about the work you do as a teenager. You might be working at a fast-food restaurant to earn some spending money. But your long-term career goal might be to become a doctor. Your fast-food job is helping you on the way to achieving your career goal of becoming a doctor.

Does that mean you should just "endure" the fast-food job and do as little as possible to get by? Not at all. Any job can help you gain skills, even though it's not going to be your career. In fact, you'll discover that the lessons and habits you form now working at seemingly "unimportant" jobs will translate directly into success (or failure) in your future career. The secret to being happy and successful in most jobs is very often your attitude. A good attitude leads to job satisfaction, which means you enjoy the work you do. Employers pick up on good attitudes and often reward their employees accordingly with better pay, better benefits, more challenging work, etc. So, what do employers look for in an employee?

**What Employers Want**

The United States Government conducted a study to identify the basic skills and abilities that teenagers and young adults would need to obtain "high-skill, high-wage employment" in a high-performance economy. Take a look at Figure 2.1 to see what these skills and abilities are.

Did you notice that one of the personal skills in Figure 2.1 is the ability to assess yourself accurately? Take some time now to review how well you stack up in each category. Think in terms of a scale from 1 to 5, with 5 being the highest. In which areas are you strong? Weak? How can you improve your weak areas?

With Assignment 2.1 as a model, on a separate piece of paper list the skills you feel are your strongest. Next, list the weakest. Then write down some specific things you can do to make more use of your strongest skill. How about a plan to improve your weakest skill?

**Making Money**

One key reason you need to know what an employer expects from you as an employee is money. You’ll see in the next unit that money—cash—is often what drives personal financial planning. Why? Because money is usually what it takes to reach your financial goals. As a general rule, employers reward employees with more money for several basic reasons. They look for employees who:

★ are dependable
★ work well with others
★ are good problem solvers
★ deliver high-quality work
★ have high productivity
★ conduct increasingly complex and unique activities
★ have great attitudes

Not many employees are rewarded just for filling a chair in the office or for taking up a spot on the factory floor day after day, year after year. Today em-

---

**Figure 2.1: Key Employee Skills**

<table>
<thead>
<tr>
<th>Skill/Ability</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic skills</td>
<td>Reads, writes, performs basic math computations, listens well, and speaks clearly</td>
</tr>
<tr>
<td>Thinking skills</td>
<td>Solves problems, organizes information, learns efficiently, and can reason things out</td>
</tr>
<tr>
<td>Personal skills</td>
<td>Goal driven, positive self-image, sociable, realistic self-assessment, and demonstrates honesty</td>
</tr>
<tr>
<td>Resource management</td>
<td>Makes good use of time, money, materials, and employee resources</td>
</tr>
<tr>
<td>Interpersonal</td>
<td>Team player, able to teach and lead other employees with diverse backgrounds, meets customer expectations, and negotiates well</td>
</tr>
<tr>
<td>Information management</td>
<td>Acquires and organizes information, and has solid computer skills</td>
</tr>
<tr>
<td>Systems</td>
<td>Works well in a system (organizational and technological), can monitor and correct performance, and suggests improvements to the system</td>
</tr>
<tr>
<td>Technology</td>
<td>Selects, sets up and operates tools and equipment (including computers), and maintains and troubleshoots equipment</td>
</tr>
</tbody>
</table>
Your choice will affect your career and your future. After High School: Then What? Enter directly into the workplace? Enter a trade school? Finish college? Your decision will impact on the money you earn over a high school diploma—that’s almost $30,000 a year extra!

Other Education Options

There are other ways besides college to further your education and increase your potential earning power. For instance, you may want to consider technical and trade schools. These are typically one- to two-year programs that will provide you with a working skill, such as PC repair, computer technical support, diesel mechanic, or para-legal assistant.

Figure 2.2: Average College Costs

<table>
<thead>
<tr>
<th>College Type</th>
<th>College Costs 2000</th>
<th>College Cost 1 yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>$24,946</td>
<td>$12,472</td>
</tr>
<tr>
<td>State (non-res.)</td>
<td>$16,848</td>
<td>$9,424</td>
</tr>
<tr>
<td>State (resident)</td>
<td>$11,338</td>
<td>$6,069</td>
</tr>
</tbody>
</table>

These costs include tuition, a dorm room and cafeteria meal plan, fees, books, and spending money for things like gas and pizza. Needless to say, going to college is not cheap. Fortunately, there are many financial resources available in the form of scholarships and student loans.

The key is knowing what you face another choice: what to do with the rest of your life. After High School: Then What? What will you do after you finish high school? Go to college? Enter a trade school? Enter directly into the workforce? Your choice will affect your career and your future earnings. More specifically, additional education and training normally have a positive impact on the money you earn in the future.

The Costs and Benefits of College Education

Education is the level of formal knowledge and training you have attained. As a general rule, the more education you have, the higher your income. That's the good news. Unfortunately, gaining more education past high school takes precious time and usually costs a lot of money. For instance, assume you want to go to college. Do you have any idea what it will really cost? Take a look at Figure 2.2 for some average college costs.

Figure 2.3: Education and Earnings

<table>
<thead>
<tr>
<th>College Level</th>
<th>Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>No High School</td>
<td>$20,724</td>
</tr>
<tr>
<td>High School Diploma</td>
<td>$34,373</td>
</tr>
<tr>
<td>Some College</td>
<td>$41,658</td>
</tr>
<tr>
<td>Bachelor's Degree</td>
<td>$62,188</td>
</tr>
<tr>
<td>Professional Degree</td>
<td>$95,309</td>
</tr>
</tbody>
</table>

College Is Worth The Expense!

This figure shows that for an average family, completing a high school education is worth about an extra $14,000 per year (compared to a high school dropout). But a college degree nearly doubles your earnings over a high school diploma—that's almost $30,000 a year extra!

Entrepreneurship

An entrepreneur is a person who creates a business from scratch, based on a need or personal expertise, and puts creativity and ingenuity into action to provide either a service or product. Entrepreneurs believe they can do a better job delivering a product or service than any existing company. That takes a keen eye to see what customers want, and the drive to meet their needs. Hint: the product or service may not even exist yet!

Many entrepreneurs are self-employed. Being in business for yourself sometimes means a lot of no’s: no guarantees, no boss, and no regular paycheck. So being an entrepreneur normally means you’re willing to take risks.

Some people work for themselves because they enjoy being their own boss, and they have few strong sense of discipline. Other people have a strong sense of discipline. Other people become self-employed in order to keep a higher percentage of profits from their labor.

Do you think you have what it takes to be an entrepreneur? How many of the characteristics that describe the typical self-employed person do you have?

Entrepreneurship—talent

Musical—talent

• Independence
• Positive attitude
• Creativity and talent
• Risk-taker
• Good work ethic and honesty
• Hard worker
• Organization and planning skills
• Self-confidence
• Good listener
• Team worker
• Decision maker
• Motivated
• Salesmanship
• Follow through

Entrepreneurship—characteristics

• Customer service
• Business management
• Entrepreneurial vision
• Innovation

Assignment 2.2

Talent or Activity

Potential Type of Business

Music—talent

Start a band

Teach private music lessons to young children.
There is more to work than just money. Job satisfaction is equally, if not more, important. Typically, you'll spend at least eight hours a day at work, so why not do something you enjoy? Beyond money and job satisfaction, there are other reasons to work.

What Employees Want

Earlier we examined what employers want in an employee. But what do employees want from an employer? That's the subject of employee benefits, which are the additional benefits offered by employers. Here are a few of those benefits:

- **Paid vacation.** Employers typically offer paid time off of up to two weeks (at least when you’re starting a new job).
- **Paid sick leave.** Just like vacation time, many employers allow five to 10 days per year of paid time off for illness, either for yourself or to take care of a family member.
- **Health-plan benefits.** Larger employers often provide health insurance for their employees.
- **Retirement plan contributions.** Many employers will put a small percentage of an employee's salary into a retirement plan.
- **Tuition reimbursement.** Some employers will pay for you to go to college or to take additional training courses.

Many times these benefits are given to employees in addition to their salaries. By some estimates, it costs an employer an additional 20% to 50% of an employee's income to provide these benefits.

As you work for different companies during your lifetime, you can decide which benefits are important at that stage in your life. Just remember to consider benefits as well as salary when you're thinking about taking a new job with a different company.

Cost of Living

If you decide to change jobs, you may be asked to move to a new area of the country. If so, an important factor to consider is the cost of living in the new city. **Cost of living** includes items like rent or home costs, transportation costs, insurance, utilities like natural gas and electricity, and food. To compare apples to apples, cost of living data lets you match up what it costs to live in your current location with the costs in a new location. For example, think about New York City compared with a small town in rural Oregon. You know that expenses like rent and auto insurance will cost much more in NYC. Food and utilities might be about the same in both areas, but most likely they will cost more in NYC.

Assume you currently live in a small town in Tennessee and get a job offer to work in NYC. If the job pays the same as you're making now, you'll really be losing money if you move, because it costs much more to live in NYC. When most people move to a new job in a new location, they expect to make more money—after adjusting for the cost of living—than before.

So from a financial planning standpoint, it's a good practice to compare both the salary and benefits of your present job in your current city to a new job in a new city—just remember to factor in any changes for the cost of living. There are many books and websites that track the cost of living for cities across the U.S.

Your Financial Future

Like a SMART goal, a retirement plan provides a path to your future. Just like a SMART goal, a retirement plan can take you closer to your chosen career. It will all happen successfully if you just remember to “plan your work, and work your plan.”

Cost of living includes items like rent or home costs, transportation costs, insurance, utilities like natural gas and electricity, and food.

Begin to identify your career choice by completing the following questions:

1. ________________
   I, ______________________ _______________
   plan to work toward a career as a ________________
   with a beginning salary of $ ________________

   The education or training that is required for my chosen career is ________________.
   This career does/do not typically provide benefits.

   Write down two steps you can take today that will move you closer to your chosen career or occupation.

   1. ________________
   2. ________________

   "It's Your Life"

   Relax and daydream. Journey down the road of life. Think about what your life will be like in five years. Visualize all the details: your family, your home, your career, your neighborhood. Think of everything you can—

   - is the town large or small?
   - Are you a quiet person or a public figure?
   - Is your job steady and secure, or exciting and risky?
   - Are you working from 9 to 5, or whatever it takes to get the job done?

   To help you better visualize, cut out pictures from magazines of your dream home, automobile, family, and so forth. Mount them on a poster board or put them in a notebook.
H ave you ever thought about where your money goes? What do you do with it? Do you spend it on food and clothes, or do you save most of your money for the ultimate European vacation? Maybe you do a little bit of both? Directly or indirectly, you've probably already spent some money today.

If you came to school by car or bus, money was spent to pay for gas. If you buy a snack during the day or buy your lunch in the cafeteria, you're going to be spending money. And that's what this unit is about, understanding where your money goes and figuring out how to make the most of it. Some of the questions you will be able to answer by the end of this unit are:

- What is a budget, how does it work, and how can it help you?
- How do taxes and other payroll deductions affect your paycheck?
- What does "P.Y.E." mean, and how can it benefit you?
- How can you make the best use of your cash?

Money Coming In

Income is any money coming in. There are many ways you can receive money. Most people think of income as money earned from a job. But let's get a little more creative. Do you receive an allowance? You've got an income. Did you get a check on your birthday? That's income, too. Sell some clothes at a garage sale? You received income.

If you have a job, you receive a paycheck, probably every week or perhaps every two weeks. I bet you have noticed that a lot of money gets taken out of your paycheck. Instead of the $100 you were expecting, maybe your check was only $80. Ever wonder why? Is there anything you can do about it?

Reading Your Pay Stub

Gross income is the total amount of income from your wages or salary before payroll deductions. Simply put, it's the number of hours you work times your hourly rate. If you work 10 hours at $7 an hour, your gross income will be $70. But that's usually not the amount you receive in your paycheck. Instead, your employer takes out certain payroll deductions.

Payroll deductions are the amounts subtracted from gross income, which results in your net income. These deductions are usually taxes, but as you grow older you'll find there are other deductions as well, such as health insurance and retirement savings. If you want to see what deductions can really do to a full-time employee's paycheck, ask your Mom or Dad to show you their pay stub.

For most working people, taxes are the biggest deduction. Taxes are fees placed on income, property, or goods to support government programs. These programs may be at a local, state, or federal level. Laws require deductions for taxes.

Generally, there are four common payroll deductions. They are federal income tax, Social Security tax (FICA), Medicare tax, and state income tax. The federal income tax is collected by the Internal Revenue Service (IRS). Most workers have federal income taxes deducted from their gross income. Most states also have an income tax. The state income tax is also subtracted from your paycheck. It is a fee collected by your employer and paid to the state revenue department to support state programs. The same process applies to the state income tax that applies to the federal income tax.

To pay for retirement and other social security needs, the Federal Insurance Contributions Act (FICA) was established. Under this system, Social Security tax is collected from most employees to fund this federal program, which provides old-age, survivors, and disability insurance. Medicare taxes are also collected from most employees to fund the hospital insurance provided under this system. These

### Earnings Statement

<table>
<thead>
<tr>
<th>Employee:</th>
<th>Pat Doe</th>
<th>Gross Income:</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSN: 000-11-0000</td>
<td>$240.00</td>
<td></td>
</tr>
</tbody>
</table>

| Deductions: | Federal Income Tax | $21.00 |
| State Income Tax | 8.60 |
| FICA | 14.88 |
| Medicare Tax | 3.48 |

| Total Deductions: | $47.96 |

Pay Period: 6/1/01 to 6/8/01

Net Income: $192.04
amounts are a set tax rate subtracted each pay period from the employee's wages. These payments are sent on behalf of the employee, with a matching amount from the employer, to the Social Security Administration.

Subtracting deductions from your paycheck leaves you with net income, also called your "take-home pay." It's the amount you receive when you cash your check or deposit it. It's the amount you have available to spend. It's also a good starting point for creating a budget.

Look at Figure 3.1 on the previous page to see how these deductions affected Pat Doe's paycheck.

**What's a W-4 For?**

It's the amount you have available to spend. It's also a good starting point for creating a budget. While it's next to impossible to get out of paying any taxes, you do have some control over how much is taken out of your paycheck. How? You can revise your Form W-4. This federal government form effectively tells your employer how much to withhold from your paycheck for taxes. An example of a Form W-4 is below (Figure 3.2).

So how do you make the most of your paycheck? By controlling the number of allowances (the adjustment to the tax withheld from your paycheck, based on your marital status and whether or not you are supporting other people with your money) you claim on your W-4.

The key is line 5: "total number of allowances." The lower the number, the higher the amount of taxes withheld, and vice versa.

If you're not a disciplined saver you can claim 0 allowances. That means you'll have a lot of tax withheld. And it means you'll probably get a refund when you file your income taxes. But it also means less take-home pay.

On the other hand, if you're more disciplined with your money, as a student you can claim 1 allowance. If you owe any money when you file your taxes, it will probably be a relatively small amount. But your take-home pay will be higher.

By the way, you always fill out a W-4 when you start a new job. But you can change your W-4 whenever you want; just fill out a new one with a different number of allowances. As a student, you'll probably want to stay in the 0-1 range. Later in life, you may want to increase the number of allowances as you earn more or perhaps have the responsibilities of a family.

**Why a W-2, Too?**

Each year, by January 31st, you'll receive an earnings summary from every employer you worked for during the previous year. It will show the taxes withheld from your paycheck for that year. That summary is called a Form W-2. You need this summary to figure your income taxes by April 15th of each year. Figure 3.3 shows an example of a W-2.

Let's see how well you understand pay stubs by completing Assignment 3.1.

**Money Going Out**

When we began this unit, we noted that income can come from a job, an allowance, or even a gift. We've also discussed how you can control the amount of money you take home. Now we're ready to talk about spending.

The money you spend on your needs and wants, money going out, is called expenses. Your expenses are typically fall into one of two categories: fixed and variable.

### Fixed Expenses

- Fixed expenses have set dollar amounts and are the exact amount every time.
- For your parents, a mortgage payment is usually a fixed amount. (Example: $750 per month). For you, a car payment might be a fixed expense (Example: $200 per month).

### Variable Expenses

- Variable expenses can change, which means you usually have more control over them. You might fill up on gas this week and not buy any next week. You might go to the movies this week and rent a video next week. Or you might choose between eating at home or going out to dinner with friends. Although it sounds like fun, if you are on cash, you might need to consider eating at home this time.

**Figure 3.2**

**Figure 3.3**

---

**Budget for Pat Doe for the week of June 6th**

| Money coming in: | Work (after taxes) | $90 |
| Money going out: | Gift/allowance | $10 |
| Total Income | | $100 |
| Total Fixed Expenses | | |

| Gas | $25 |
| Food | $20 |
| Clothing | 15 |
| Fun stuff | 50 |
| Utilities | 35 |

| Total Variable Expenses | $95 |

| Total Outgoing | (fixed + variable expenses) | $100 |

---

**Cash Management**

**Cash management** is how you handle money coming in and money going out. Sometimes it's referred to as "cash flow." As you might expect, there are some tools available to help you manage your money (cash). One of the best is a budget.

---

**Building Your Own Budget**

What's the point of having a budget? Remember that a budget is your roadmap to achieving your goals (like the SMART goals you set in Unit 1). When you're in control of your spending, you are able to make clear, planned decisions on the best way to spend your money and make your money work for you.

Another reason to have a budget is that, if you're like most people, your money is limited. You can work only so many hours a week at a job, and that often limits your income. So it's important to be thoughtful about how you spend your take-home pay.

---

**Assignment 3.1**

Analyzing a Pay Stub

| Employee: | Tom Smith |
| Pay Period: | 7/30/01 to 8/30/01 |
| Pay Date: | 7/31/01 |
| Net Pay: | $231.71 |

---

**Figure 3.3**

---

**Table 3.1**

<table>
<thead>
<tr>
<th>HOURS</th>
<th>EARNINGS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>REGULAR</td>
</tr>
<tr>
<td>TIP</td>
<td>40</td>
</tr>
<tr>
<td>YTD</td>
<td>$960.00</td>
</tr>
</tbody>
</table>

---

<table>
<thead>
<tr>
<th>DEDUCTIONS</th>
<th>REGULAR</th>
<th>O/T</th>
<th>REGULAR</th>
<th>OVERTIME</th>
<th>STATE W/H TAX</th>
<th>PENSION</th>
<th>OTHER</th>
<th>NET PAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOCIAL SECURITY TAX</td>
<td>$218.77</td>
<td>-</td>
<td>$15.88</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$234.65</td>
<td></td>
</tr>
<tr>
<td>MEDICARE TAX</td>
<td>$218.77</td>
<td>-</td>
<td>$15.88</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$234.65</td>
<td></td>
</tr>
<tr>
<td>FEDERAL W/H TAX</td>
<td>$17.40</td>
<td>-</td>
<td>$12.50</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$29.90</td>
<td></td>
</tr>
<tr>
<td>STATE W/H TAX</td>
<td>$17.40</td>
<td>-</td>
<td>$12.50</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$29.90</td>
<td></td>
</tr>
<tr>
<td>PENSION</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>OTHER</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>NET PAY</td>
<td>$231.71</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

---

**Assignments**

1. What is Tom's gross income? $750 per month. For you, a car payment might be a fixed expense (Example: $200 per month).
2. What is the length of the pay period Tom just worked? 6 weeks.
3. How many total hours did Tom work during this pay period? 40 hours.
4. What amount of hours does Tom get paid for regular hours worked? $240.00.
5. Did Tom work any overtime this period? Yes, $54.00.
6. What amount of hours does Tom get paid for overtime? $25.00.
7. What is Tom's gross income for this period? $294.00.
8. List the type and amount of each payroll deduction for Tom for this pay period.
9. What was the total amount of his deductions this period? $231.71.
10. What is Tom's net income (take-home pay) for this pay period? $231.71.
11. What amount has been available for Tom's financial goals year-to-date? $960.00.
expenses the very first item listed. What in the world is P.Y.F.?

P.Y.F. ("Pay Yourself First")

P.Y.F. stands for "pay yourself first," and it's a very simple, effective idea. You don't have a choice about paying taxes. Yes, you can control the amount to some degree, but the government still gets its taxes. P.Y.F. is the secret to getting what you want and becoming a disciplined saver. Saving is simply setting aside money to spend later. It's the same technique the government uses to collect income taxes on a regular basis, although most people never think of it that way. It's a simple trick almost every self-made wealthy person uses, and may also be one your parents use to save.

P.Y.F. (pay yourself first) follows the same principle: don't give yourself a choice. Make it a regular part of your budget. Think of it as a bill you owe to yourself. Why? Because it's the P.Y.F. money in your plan that helps you reach your goals. Why not begin today to save 10%, or just one thin dime, from every dollar you get?

With a limited income, you have to make tough choices about how you spend your hard-earned money. Having P.Y.F. money in your budget makes it possible to reach your long-term goals. Without it, you'll probably never get past your short-term goals, and you may even reach those.

P.Y.F. is another one of those lifetime money-management principles. You'll be dealing with money for the rest of your life, so consider P.Y.F. the gift of a lifetime. The earlier you develop the habit of saving, which is essentially what P.Y.F. is, the better off you'll be.

Using Pat Doe's budget as a model, create your own weekly budget (Assignment 3.2). If you are currently working, remember to include income after taxes, and P.Y.F. Feel free to add or change the categories, as you need.

Making the Most of Your Dollars

While we're on the subject of spending, let's talk about how to make your dollars go farther. One way is to shop for items on sale. But there are other ways to stretch your dollars.

A relatively new trend is buying and selling items through online auctions on the Internet. There's also the "old-fashioned" technique of using coupons (at grocery stores, restaurants, etc.). Often, you can find bargains at garage sales and thrift stores. But sometimes you have to pay full price for a product or service. Perhaps a used item isn't available, or there are no sales or discounts offered right now. How do you know if you're getting a good deal? Usually, all it takes is a little research.

Advertisers and marketers exist to make products and services as appealing as possible. But just because a product claim is in writing doesn't necessarily make it true. You need to learn to evaluate sales pitches and separate truth from fiction.

One direct way of getting the facts about a product or service is by reading the "fine print." Magazines, newspapers, and even television programs will sometimes have write-ups about how a product performs. There are also publications and organizations dedicated to product/service evaluation (such as Consumer Reports). Another good source of information are your friends and family, or check out bulletin boards on the Internet. Ideally, you're looking for someone who owns the item and can tell you honestly about his or her experience using it.

Cost/Benefit Analysis

A cost/benefit analysis is another simple tool you can use to choose between alternatives. In effect, you are weighing the cost of a product or service against the benefit it will provide.

For instance, assume you're thinking about going to college, you can imagine a similar decision: do you go to a state university or a private college (compare the costs, the degree programs available, the typical jobs and salaries offered to grads, etc.)? Taking the time to go through a cost/benefit analysis can help you make better decisions.

What Do You Spend Your Money On?

Do you ever wonder if you're like everybody else when it comes to spending money? The graphic below shows how the average teenager spends his/her money. Most likely you'll find that your spending priorities are a little different, and that's okay.

Transaction Services

A checking account is an essential tool for handling cash, especially when you have a job. With a checking account you deposit your paycheck, or any other money you receive, and when you need money, you have several options.

Assignment 3.2

Create Your Own Budget

Budget for the week of June 6th

<table>
<thead>
<tr>
<th>Money coming in:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Work (after taxes)</td>
<td></td>
</tr>
<tr>
<td>Gifts/Allowance</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Income</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Money going out:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Expenses</td>
<td></td>
</tr>
<tr>
<td>PYF</td>
<td></td>
</tr>
<tr>
<td>Car payment</td>
<td></td>
</tr>
<tr>
<td>Auto insurance</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Fixed Expenses</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Variable Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gas</td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td></td>
</tr>
<tr>
<td>Clothing</td>
<td></td>
</tr>
<tr>
<td>Fun Stuff</td>
<td></td>
</tr>
<tr>
<td>Big events</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Variable Expenses</th>
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<table>
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<tr>
<th>Total Outgoing (fixed + variable expenses)</th>
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<table>
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<tr>
<th>Any money left over? (Income minus outgo)</th>
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Assignment 3.3

How Do You Spend Your Money?

Using the expense categories and amounts you created in your budget in Assignment 3.2, draw a pie chart on a separate paper showing how you spend your money. It might look something like Pat's in the following example, which is based on her budget.
You can write a check. When you pay regularly occurring bills, like car payments or car insurance, or when you need some cash, you can write a check.

You can use an ATM card. If you need cold, hard cash from your account, you can use an Automated Teller Machine (ATM) card. Enter the card and your personal identification number (PIN), and out comes your cash. Caution: remember to record and subtract these amounts in your checkbook.

You can use a debit card linked to your checking account. A debit card is just like a credit card purchase, except the amount is immediately subtracted from your checking account electronically. In some ways, a debit card works like an "electronic" check. Again, make sure you record each transaction in your checkbook.

It pays to shop around when you’re thinking about opening a checking account. Banks and credit unions are two of the most popular places to open these accounts, but charges, fees, and other costs may be added on, so watch for the following:

- **Minimum balances.** Some accounts may require that you keep a certain amount in the checking account at all times, such as $200. If you fall below that amount, the financial institution may charge a fee (such as $5 per month) or close your account within a certain time period (like 30 days).

- **Annual or monthly fees.** Some accounts may charge you a fee (such as $3 to $5 per month) just for the privilege of having the checking account.

- **Overdraft protection.** If you write a check for more money than you have in your account, the bank or credit union may honor the check but charge you a fee for doing so. In effect, the bank is making you a short-term loan to cover your check. Accordingly, you may see an interest charge on your next statement, and maybe even a fee for overdrafts. Interest rates on overdrafts can vary greatly, so do your research before using this account. Better still, always balance your checkbook and never use the overdraft option.

- **Insufficient funds charge.** If you write a check for more money than you have in your account (a "bounced" check) and you don’t have overdraft protection, the credit union or bank will return your check unpaid. They will also charge your account an insufficient-funds fee. These fees can range from $15 to $30 per check. The company, or person, you wrote the check to might get charged by their bank as well. So by writing a "bad check," you may run up additional charges of $30 to $50 per check.

- **ATM fees.** If you use an ATM that belongs to your credit union or bank, there may be no cost at all. However, if you use an ATM “outside” your financial institution’s network, there may be additional fees ranging from $1-$2, or more, for each withdrawal, deposit, or check, and that can really add up. Again, find out the costs before you open the account.

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The Envelope System

Maybe you don’t have a regular paycheck, or you don’t feel like you have enough money to bother with a checking account. How can you manage your cash? You can use an envelope system. This simple system works very nicely with your budget. Here’s how.

Label an envelope for each spending category of your budget (such as savings, food, gas, entertainment), and record the planned amount on the appropriate envelope. As you receive money each time period (weekly, biweekly, or monthly), place the planned amount in each envelope. When you need to spend money, pay for food, you take cash out of the “food” envelope. When an envelope is out of cash, you’re done spending for that category. Of course, if you’re out of “food cash,” you can simply move “extra” money from another envelope to the “food” envelope.

Every time you add or remove money from an envelope, write down the date, the amount, and the reason on the envelope itself. Then you’ll have all your tracking information in one place, and you can easily see where you have over- or under-spend. And best of all, you’ll know why. Start with a new set of envelopes for each new planning period.

**Record Keeping**

As you gain more financial experience, you’ll have more accounts and obligations. If you want things to be easier for you in the future, it’s a good idea to get in the habit of staying financially organized now. A small stack of manila folders makes for a neat and organized filing system. Here are some records you’ll definitely want to keep:

- **Checking account statements.** Every month balance your checkbook to your account statement. If you use the ATM, be sure to account for all your withdrawals. The same applies to all debit card transactions, if you use that tool.

- **Savings and investments.** We’ll talk more about the specifics regarding savings and investments in Unit 4. For now, know that you should check these statements when you receive them, just like your checking account statement.

- **Insurance.** If you’re buying car insurance, keep a copy of the “declarations” papers, which contain important information about your car, such as coverage amounts and deductibles. There will be more about insurance in Unit 6. Also, make sure you pay promptly, and keep all premium notices sent by your insurance company.

- **Tax documents.** Keep copies of all W-2s you receive, tax documents for any savings and investment accounts, and all completed tax returns for earlier years, such as Form 1040, which you’ll file every year by April 15th.

**Action Steps**

**"PAYDAY: Part of All Your Dollars Are Yours Quick Check— How Are You Doing?" (circle your answers)**

1. Do you have written goals? YES NO
2. Do you save regularly? YES NO
3. Do you have a budget? YES NO
4. Do you pay what you owe promptly? YES NO
5. Do you think ahead before you buy? YES NO
6. Do you buy only what you need and will use? YES NO
7. Do you pay F.Y. YES NO

From what you learned in the “Quick Check,” write down two steps you can take this week to improve your financial habits.

1. ____________________________________________
2. ____________________________________________
3. ____________________________________________
4. ____________________________________________
5. ____________________________________________
6. ____________________________________________
7. ____________________________________________
In Unit 4, you learned the techniques of P.Y.F. Now you need to put that money somewhere. You could keep it in your pocket, or stash it under your mattress, or keep it in a jar or locked box in your room. But are these really good choices? Where are some of the best places to put the money you save?

Depending on your goals and the amount of money you have, you could put it in a savings account, or you could begin to invest it. Understanding when to save or when to invest is an essential step.

The big difference between savings and investments is time. Savings is usually money you set aside for short-term goals. One reason you might save money now is so you have some more money to invest later. Money deposited into a savings account is usually very safe and probably earns a small amount of money. Another neat thing about a savings account is you can get your money out of the account whenever you want. When you invest you set your money aside for future income, benefit, or profit to meet long-term goals. When you invest your money, there is no guarantee that your money will grow or increase. The earnings or losses from investments are usually more than what you would make or lose in a savings account. Investors recognize that it usually takes a long time to earn the big bucks, so most of the time they are in it for the long haul.

In Unit 3, you learned how to make a plan and stick to it. The rest of this unit will help you understand how to develop the habit of saving.

Why is Money Important?

Go ahead, do some "blue sky thinking" about what you really want. What are some of the goals you have been writing and thinking about? Then, think of money as the tool to help you achieve these goals.

Maybe what you would like is a new computer, ballet lessons, or a horse to ride. How about ski passes, golf lessons, or some fantastic jewelry? And yes, probably some day, a house of your very own.

Connecting the money you have to the things you want can be done with good choices, time, a plan that balances risk, and your commitment to yourself. Do you know that many adults never reach their goals because they don’t know what you are learning right now? They don’t know how to make a plan and stick to it. The rest of this unit will help you learn what you’ll need to know about saving and investing. Why? So you can make your dreams and goals a reality!

True Value of Money

Let's take a look at how saving and investing work. Time value of money is the relationship between time, money, and rate of return (interest), and their effect on savings growth.

Let’s check out an example of this idea. A dollar you receive in the future may be worth more or less than a dollar in your hand today. That dollar will be worth more if you invest it and it grows in value. For example, $1 today might increase in value to $1.15 in two years. That is your earned interest. Earned interest is the payment you receive for allowing a financial institution or corporation to use your money.

Saving and investing are very important parts of your financial plan. How much your savings and investments earn over the period of time can be a significant factor in helping you achieve your goals. Three factors determine how much money will be available to meet your specific financial goals. These three important factors are time, money, and rate of interest.

1. The more time you have to save, the more money you will have at the end of the time period.
2. The more money you have to save, the more money you will have at the end of the time period.
3. The higher the rate of interest you can earn, the more money you will have at the end of the time period.

Pretty cool, huh? But the really neat thing is you have the dynamics of time and compound interest on your side because you have more time to save and invest! On the other hand, if you leave that dollar in the locked box in your room for the next two years, it may not be worth as much at the end of that two years. Why? Because the value of that one dollar today might fall to just 90¢ in the next two years. That’s because prices for goods and services usually increase over time. You know the lecture you get from your grandfather when he reminisces about the day when he paid ten cents for a pack of gum? Well, that’s what economists refer to as inflation. The point is, the value of money—a dollar—will change over time.

Compounding

When your money is working for you, it grows in value or compounds. Compounding, or compound interest, is the idea of earning interest on interest. This is one of the greatest aspects of personal finance, so you should probably listen up and read on. Assume you have $100 in an account earning 10% interest per year. At the end of that one year, you have $110 in your account. In year two, your account also earns 10%. How much do you have at the end of the second year? $121? No; as it turns out, you have $121. Where did that extra dollar come from? Compounding. In year two, you still have your original $100 working for you at 10%. But you also have the $10 of earnings—from year one—working at 10% as well. Multiply $10 by 10%, and you get a total of $11 of earnings for year two. Add that to your account value at the end of year one, and you wind up with the $121.

Albert Einstein was so impressed with this concept that he called compounding the "8th wonder of the world." You don’t have to be a genius to figure this
compounding stuff out, and the super thing is you can begin to take advantage of it right now. Just include it as part of your financial plan. The important thing to remember is the amount you save is not as important as establishing the savings habit now. Savings that earn interest grow into an investment fund. Your money will be working for you by earning interest. Individuals who learn to pay themselves first generally have money when they need it. Now let’s test your understanding of compound interest by completing Assignment 4.1.

The Rule of 72

Mathematicians have come up with a simple rule based on this concept of compounding. It’s called the Rule of 72, and it tells you how long it takes your money to double in value. This is an incredible way to earn more money without lifting a finger. Well, you may have to lift a finger to move some of your earnings into your savings account to an investment fund, but you get the drift.

Here’s how it works. You divide 72 by an interest rate to determine the number of years it will take your money to double. For example, assume you can earn 6% on your money. How long will it take $100 to grow to $200?

72 ÷ 6% = 12 years

That’s right. At 6%, your money will double in value in 12 years.

On the other hand, say you have a set time period in mind. You can figure out what interest rate you need to earn to double your money. If you have $200 today and need a total of $400 in eight years, what interest rate do you need to earn?

72 ÷ 8 years = 9% interest

With eight years to invest, your money will double if you can earn 9%.

Along with compounding and the Rule of 72, there are some other concepts you can use to your advantage with your savings and investments.

Key Investment Principles

Time

We touched on the importance of time earlier when we discussed the time value of money. But let’s expand on that key point a little more. The fact is, the more time you have to reach your savings goal, the more money you will have at the end of that time. For example, assume you’re 16 years old and decide to invest $1,000 a year—money you earned from your summer jobs—in an account that grows by 9% per year. You faithfully set aside the money each year for 10 years, but you decided to stop at age 23.

At that time, you finally convince your best friends—you are also now 25—to start setting aside some money for their future. They begin now to put away $1,000 every year, and they also are able to earn 9% on their money. After 25 years, you all get together at your 50th birthday party and compare notes. Who has the most money? Figure 4.1 shows the surprising result.

Even though your friends invested more than twice as much as you did, you end up with over $46,000 more. Why? You took advantage of time, by starting to save earlier.

Risk and Return

When many people hear the word “investment,” they think of the stock market and the risks that go with it. Investments in the stock market do have risks, and you can certainly lose money on stocks—or any other investment, for that matter. But with higher risk comes the potential to earn higher rewards or returns on your investments. This risk-to-return relationship is another key investment principle. The more risk you take with your money, the greater the potential return you receive. However, the reverse is also true—less risk, less return on your money.

Figure 4.2 shows this principle for some common categories.

The Impact of Higher Returns on Savings and Investments

Assume you have $100 to invest right now. Using the interest rates provided and your knowledge of the Rule of 72, determine how long it will take to double your money and write that amount in the appropriate column.

Rule of 72: The Approximate Frequency with which $100 Doubles at Specific Interest Rates

<table>
<thead>
<tr>
<th>Interest Rate</th>
<th>3%</th>
<th>4%</th>
<th>6%</th>
<th>8%</th>
<th>12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 Yrs</td>
<td>23</td>
<td>18</td>
<td>12</td>
<td>9</td>
<td>6</td>
</tr>
<tr>
<td>9 Yrs</td>
<td>18</td>
<td>14</td>
<td>9</td>
<td>6</td>
<td>4.7</td>
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<tr>
<td>12 Yrs</td>
<td>15</td>
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<td>8</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>18 Yrs</td>
<td>12</td>
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<td>6</td>
<td>4.7</td>
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<tr>
<td>24 Yrs</td>
<td>10</td>
<td>8</td>
<td>6</td>
<td>4.7</td>
<td>3.7</td>
</tr>
</tbody>
</table>

Let’s look at another example. You challenge a friend to an investment contest. You each have $100 to invest, and there are two choices. Savings Account A grows at 4% per year for 10 years, while Investment B grows at 8% per year for the same period. Say you wisely choose Investment B. Who will have more money in 10 years? You or your friend? Look at Figure 4.3.

Even though you both started with the same amount of money, at the same time, and let it grow for the same time period, Investment B is worth $68 more. Why? Because it grew at a higher rate of return.

Diversification

People have different ideas about how much risk they should take with their money. Some are conservative and want to keep it some place safe, like a savings account. Others are more aggressive and are willing to invest it some place riskier, like the stock market.

Regardless of your investment style, every wise investor knows that diversification is a critical element of any investment plan. It’s pretty simple really.

Diversification is the reduction of investment risk by spreading your invested dollars among several different investments. It’s simply spreading your money around among different choices. When you divide your money up among different types of savings and investments, you reduce the chance that any one of them will really hurt you financially with a drop in value.

*Rather than trying to win a lot of money through games of chance, you can make your own luck through smart investment planning. The graph below shows how long it will take to save $1 million at different rates of return, assuming you invest $2,000 per year. If you were to invest more, you’d reach your goal that much faster!*

Assignment 4.2

The Impact of Higher Returns on Savings and Investments

Assume you have $100 to invest right now. Using the interest rates provided and your knowledge of the Rule of 72, determine how long it will take to double your money and write that amount in the appropriate column.

Rule of 72: The Approximate Frequency with which $100 Doubles at Specific Interest Rates

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Inflation and Taxes

We saw earlier how compounding can make money for you by earning interest on your earnings. Unfortunately, compounding can also work against you. When this unfortunate occurrence happens, it’s called inflation.

Inflation occurs when the price of goods and services rise. We’ve had inflation in our economy for...
decades, ranging from barely .5% to over 18% in a year. Fortunately, inflation usually averages between 0% and 1% per year. What does that mean, and why should you care? It means that you’re going to be paying more in the future for the same pair of tennis shoes, skateboard, purse and chicken wings.

Because we usually do have inflation—even in small amounts—year after year, that becomes a problem. A dollar in the future won’t buy as much as a dollar today. Think about the cost of a first class postage stamp. In 1971, a first class stamp cost 8¢. How much is that stamp today? One of the reasons the stamp costs more is because of inflation. The same trend will probably hold true in the future for other goods, like food and clothing.

Here’s an example of how compounding works for you—a positive result of inflation—and against you—inflation (losing money)—at the same time. Today, a large soft drink at your favorite fast-food place costs $1. You buy the soft drink but also decide to save some money for the future as well. So you put a dollar in your savings account, where it earns 5%.

Next year, the dollar in your savings account is worth $1.05. You take your savings out and visit your favorite fast-food place again. You’re ready to buy your favorite soft drink, until you realize the price has gone up to $1.10.

Inflation has gone up faster than your earnings. Can it happen? You bet. It has and it will, depending on the type of savings or investment you choose. The point is that inflation can work against your money so you need to protect yourself against that risk whenever you can. Learn to invest wisely, follow the rate of inflation, and choose your investment rates higher than those of inflation.

Taxes are the other drain on your savings and investments. When you have income from a job, the federal and state government collect their share of taxes from you, just like we discussed in Unit 3. When you have income from your savings and investments, such as dividends and interest, federal and state governments tax those earnings as well.

When you earn interest in a savings account, the government taxes those earnings just like income from a job. If you buy and sell investments, like stocks, for instance, the government taxes you on any gains or income or growth. The rules vary depending on how long you’ve owned an investment, but the bottom line remains the same: you’ll pay taxes on any earnings from your money.

Are there types of savings and investments that can overcome inflation and minimize the impact of tax? Yes there are, and that’s the focus of the next section.

**Savings Accounts**

Banks and credit unions pay investors to loan their money to other financial institutions. These payments are called interest, which can be defined simply as the price of borrowing money. Because the federal government guarantees the safety of the account, you have very low risk and thus tend to pay low interest rates. You can usually take your money out whenever you want, without any restrictions.

**U.S. Savings Bonds.** The federal government pays cash to investors for the future right to loan it money, just like the banks and credit unions. But bonds are different than savings accounts. First of all, a bond is a formal agreement between a lender and a borrower concerning a time period. In exchange for loaning it money for a certain length of time, the U.S. government agrees to pay you cash—interest. If you cash in these bonds within five years of purchase, it will cost you a penalty. Usually the penalty is three months of lost interest. Therefore, you’ll pay higher rates of interest than savings accounts.

**Certificates of Deposit (CD).** Not to be outdone by the government, banks and credit unions have their own versions of bonds called certificates of deposit. In exchange for loaning them your money for a set period of time, either six months, one year, two years, etc.—banks and credit unions pay you interest on your money. The longer the term, the higher the rate of interest paid on the CD. CDs usually pay a slightly higher rate of interest than savings bonds. But like those bonds, you will lose a few months of interest if you cash in your CD early.

**Money Market Accounts.** Many banks, credit unions and mutual fund companies offer money market accounts. These work like checking accounts and pay you interest on the amount of money you have in the account, usually with no penalty. Some financial institutions may limit the number of checks you can write from your account or may require a higher deposit into the account to open it.

**Growth Investments (Owners) Stocks.** Stocks are investments that represent ownership in a company. When you own a company’s stock, you are a part owner. For example, assume an investor buys Stock XYZ for $10 a share in 1995. In 2001, the investor sells XYZ for $25 per share. The difference in price, $15, is the investor’s profit, or capital gain.

Over longer periods of time, such as 5 or 10 years or longer, stocks tend to generate higher rates of return than income investments. But because stocks can also lose value, they are considered to be riskier than income investments. On the plus side, growth investments like stocks have historically earned rates of return that consistently exceed the rate of inflation.

**Real Estate.** Investors buy pieces of property, such as land or a building, in hopes of generating a profit. If you live in a house owned by a family member, your family owns real estate. There are many other forms of real estate investments, such as malls, apartment complexes, undeveloped land, commercial buildings, and farmland.

**Collectibles.** Collectibles are usually unique items that are relatively rare in number. Examples include paintings, sculptures, and other works of art. If you own a collection of antique porcelain figurines, you may have collectibles. Just like stocks or real estate, collectors buy items they hope will go up in value over time. When they later sell the item at a higher price, they lock in their earnings in the form of capital gain.

Because not many people trade collectibles, investors value them as very high in risk. When you want to sell your treasures, the demand one year may be out of vogue the next. Prices for collectibles can change quickly and dramatically. It helps if you really have expert knowledge about a particular collectible, such as classic cars, so you know if you’re getting a good deal or not.

**Mutual Funds**

When it comes to making investment decisions, investors are on their own. They can do it on their own, or they can hire a professional to make their money management choices for them. Investors who want professional management turn to mutual funds.

A mutual fund pools money from several investors and uses the money to buy a particular type of investment, such as stocks. A fund manager, who is an investment expert, makes all of the buy and sell decisions for the investments in the fund. Because mutual funds own a variety of investments, investors enjoy the benefits of diversification, which we discussed earlier. For these and other reasons, mutual funds can be a great choice for investing.

Mutual funds are created for several different purposes or objectives. Some are designed to invest in very specific assets, such as bonds, CDs, and other income-producing items. Some are designed for growth and invest in stocks or real estate.

Mutual funds invest in almost any area of the business world. If you can imagine it, there is probably a fund in existence that specializes in a particular type of business or product. There are funds that invest in technology, in food and agriculture, in government bonds, in foreign countries, in energy, and even in gold or other precious metals. So if you have a particular interest in a product or service and you want to invest in the company, you can do so easily by hiring a professional money manager and investing in a mutual fund.
**Unit Five**

**Credit: Buy Now. Pay Later**

**Can You Believe?**

With a partner, fill in the following:

- _____% of students with a credit card don’t repay the entire balance each month.
- _____% of teenagers say they have never discussed using credit cards responsibly with a family member.
- _____% of teenagers say they are pretty familiar with credit cards.
- _____% of teenagers have access to a parent’s credit card.
- _____% of teenagers aged 18-19 already have a credit card in their own name.

**To use credit wisely you need to know what’s really involved.**

**Knowledge is power,** as the saying goes. To use credit wisely you need to know what’s really involved. **Credit** means someone is willing to loan you money—called principal—in exchange for your promise to pay it back, usually with interest. **Interest** is the amount you pay to use someone else’s money. The higher the interest rate, the greater the costs of using credit.

In fact, the biggest cost of using credit is the interest rate, so it pays to shop around, and lenders make it easy to compare costs. All interest rates are quoted as an **annual percentage rate** (APR). The APR is the amount it costs you a year to use credit, expressed as a percentage rate. It includes the interest, transaction fees, and service charges.

In addition to the APR, there may be other costs of using credit. The following fees and charges apply to various kinds of credit.

**Annual fee.** Most often used by credit cards companies, an annual fee is a yearly charge for the privilege of using credit.

**Finance charge.** This is the actual dollar cost of using credit, which is calculated by a lender.

**Origination fee.** An origination fee, usually associated with home loans, is a charge for setting up a loan.

Another key piece of information you need in order to use credit wisely is the **loan term,** or how long the loan lasts. The longer the loan term, the greater the cost of using credit. That’s because the longer you keep a balance on a card, the more money you have to pay in interest over that time. Let’s take a closer look at the price of using credit.

**Credit Costs**

In Unit 4 we saw how compounding helps you earn money on your savings and investments. But we also learned that compounding can work against you in the form of inflation. The bad news is that credit is another instance where compounding can work against you.

**Loan Length.** Figure 5.1 compares two loans, both with an interest rate of 8% and an identical amount of $1,000. But, they have different loan lengths. The first is a four-year loan, while the second has a six-year term.

Notice that it costs an extra $90 for an additional two years of loan payments. That doesn’t sound like much until you think of it as an extra $90 per $1,000 borrowed. Imagine the additional costs if you were looking at a $10,000 loan or even a $100,000 loan! To put it in perspective, let’s say you’ve found the house of your dreams. You take out a $100,000 loan at 10% with a loan term of 30 years—a common length for a house. How much will you really be paying for your home, if you pay off the loan as scheduled? Take a look at Figure 5.2.

In effect, you bought one house but paid for three! The point? The longer the length of the loan, the greater the overall cost to you.

**Interest rate.** Here’s another way to look at it. Compare two loans, both for $1,000 for five years, but with different interest rates. The first loan has a rate of 9%, which would result in $246 in interest. While the second rate is 12%, resulting in $334 in interest.

In this example, the higher interest rate means the loan costs an additional $88. Again, that’s not a lot of money, but if you think of a loan for tens of thousands of dollars, higher rates can add substantial costs to borrowing.

The cost of credit should be included in your decision when you are considering borrowing money. Remember: High interest rates mean that the borrowed money costs more to use.

**Credit Benefits**

Now that you know some of the costs, you may be wondering if using credit is worthwhile. As with many financial tools, it depends on your situation. Credit does have potential benefits, if you use it responsibly. And that’s the key. Here are some examples of responsible credit use.

**Access to cash in an emergency.** When you need money to pay for something in an emergency, like a tow truck if your car breaks down, having credit can get you back on the road quickly.

**The ability to use it now.** Credit allows you to own a benefit from the use of large purchases now, such as a car or a house. Without credit, most families would probably not be able to buy a home or even a new car.

**Safety and convenience.** If you can charge a purchase on a credit card, you can avoid carrying large amounts of cash. When you’re traveling, major expenses like hotel rooms, airfare and car rentals can all be put on credit cards. Also, many purchases can be made over the phone from catalogs or on the Internet with a credit card.

**Earn bonus points or miles.** Credit card issuers fre-
Credit Cards

A credit card is synonymous with "buy now, pay later." Credit card companies have with "buy now, pay later." Unlike many forms of credit, credit cards let you vary how much you can charge. This maximum is called the credit limit. Once you've reached your limit—say $500—you're "maxed out." At that point, you can't make any new purchases until you pay down the balance owed. Higher limits may sound good, but you need to consider avoiding running up big loan amounts. If you're tempted to overspend, remember that big purchases quickly compound into big interest payments with high APRs. You're the one who will pay for it.

To help you shop for the best credit card, make a chart like the one in Assignment 5.1. Compare at least three different cards. You can shop on the Internet, or ask your parents to save some of the credit card offers they receive in the mail. How Long Can It Take? Imagine you've graduated. You're living on your own, and you have a credit card in your own name. With a $500 credit limit, you've maxed-out your card in just a few days. At an APR of 18% and an "easy" minimum payment of only $15 a month, how long will it take you to pay off your card?

Almost four years! Plus you'll have paid about $180 in finance charges. This assumes you don't make any new purchases on the card for almost four years. Is that so bad? It depends on your plan. Would you have been wiser to have waited and saved the money for the purchases and saved that $180 in interest? Now let's look at the same scenario, but with different dollar amounts. Assume you have a $2,000 credit limit, and it's maxed out. But you don't plan to make any more purchases until the card is paid off. This requires a minimum payment of 2% of the balance, or $20, whichever is greater. How long will it take you to pay off this card?

It will take more than 18 years! Total finance charge: Over $3,500. You'll spend about $5,500 over 18 years so you can enjoy $2,000 worth of purchases today. That's the price of choosing instant satisfaction over delayed gratification. Many times you are going to be better off saving your money and paying cash instead of borrowing.

Installation Loans

If you need a loan for a large purchase, such as a car or an appliance, you can take out an installation loan. Installation loans require you to make payments on a regular basis, usually monthly, until the loan is paid off. Banks and credit unions offer installation loans for many purposes, while car dealers offer them only for auto purchases. Interest rates on installment check for prepayment penalties. These are penalties for paying off your loan early. Lenders sometimes charge prepayment penalties because they will be losing the interest you would have paid over the remainder of your loan.

Student Loans

If you're heading off to college, you may need some help paying for it. If so, you might be interested in a student loan. In addition to banks and credit unions, the federal government also makes loan dollars available to pay for higher education.

Mortgages

If you buy a home some day, you'll probably need to take out a mortgage loan as we discussed in the example in Figure 5.2. It works much like an installment loan, except the length of the mortgage extends over a long period of time—usually 15 years.
thump to help you. You’ll want to adjust them to fit the goals and values reflected in your financial plan.

How much is too much? A maximum of 20% of your net income goes to your home pay after taxes—should go toward all of your loan payments (excluding a mortgage). That means your credit card payments, car loan, and any other loans you have should add up to less than 20% of your pay. To be safe, keep it to 15% or less.

For instance, assume your take home pay is $1,000 per month from a full-time job. No more than $200 a month should be going toward your car payment, credit card payments, etc. That’s not much, and it’s another reason to seriously consider your career plan, since it will have a direct effect on your income.

What is a co-signer? Most lenders don’t want to see more than 33% of your take-home pay going for a mortgage payment. Assuming you take home $1,000 a month, the most you could pay on a mortgage would be about $333.

Comparing Credit Offers

You can use a chart similar to the one in Assignment 5.1, “Shopping for the Best Credit Card,” for any type of loan or credit. Remember to check for:

• the APR
• the loan term, or length of the loan
• the maximum amount of the loan
• the minimum payment amount
• any annuity or up-front fees
• any prepayment penalties
• additional fees, such as those for exceeding your credit limit, making a late payment, or bouncing a check to the lender, and
• the amount of income you need to qualify for the credit.

Credit Reports

Having a high school diploma or college degree is the first step toward ensuring a successful career. Similarly, your credit report can be your first step in guaranteeing future loans when you need them. Your credit report will be with you for a long time, so make it shine!

Your Credit Record

A credit report is simply your credit history by the major credit reporting agencies: Experian, TransUnion, and Equifax. When you apply for a loan, lenders review it to see how well you have managed credit in the past. Your credit report contains information the lender may consider for, loan amounts you received, and whether you paid your bills on time or not at all. In short, a credit report is kind of like a financial timeline. It reflects your credit history for the past seven to 10 years.

Every potential lender will thoroughly examine your credit report, and many employers check it when making hiring decisions. When you apply for a car loan or a credit card, the first place the lender looks is your credit report.

How do you build a good credit history? When you use a checking account, don’t bounce checks. When you open a savings account, make additional deposits—regardless of the size—on a regular basis. Lenders like to see consistent patterns in saving. Always pay your bills on time; it shows lenders you are responsible.

When you’re still in school, it’s often tough to get credit on your own. One way to get started is to ask a parent or trusted adult to co-sign with you, perhaps for a credit card. Having a co-signer is a financial responsibility: if you don’t pay your bill, your co-signer is on the hook—legally and financially.

Once you have established credit, make your payments on time. If you handle a little credit responsibly, lenders are more willing to extend larger amounts in the future. There are other things you can do to qualify for more credit, which are discussed in the next section.

Credit Scoring

Many lenders use a mathematical model to produce a credit score for you. The score helps lenders predict the likelihood that you will pay your bills as promised. Your score will change over time as your financial situation changes. The factors that go into the score vary from lender to lender, but the following are generally included:

Capacity. Lenders want to know if you have the ability to repay a loan, so they look at your income and employment history. A pattern of rising income and/or steady employment will give a lender more confidence. On the flip side, if you already have high credit limits, lenders may worry that you won’t be able to make your payments.

Character. In essence, lenders want to know if you are trustworthy. One way they measure your character is by looking at your credit report. Paying bills on time shows personal financial responsibility. If you have used credit in the past, they want to see that you make your payments on time.

Capital. Lenders take comfort in knowing you have personal items of value. In a worst-case scenario when you don’t pay your bills at all, a lender might sell your personal possessions to repay the loan. Typical items of value include a car, an investment account, and, in some states, your home.

Debt

When you decide to use credit, the amounts you borrow add up to become your debt. Debt is the entire amount of money you owe to lenders. We discuss the downside of debt a bit earlier—you can enjoy an item or a service now. The downside of debt is that it puts a claim on your future income, and if you take on too much debt, it can derail your financial plan—and your future.

Top Ten Questions to Ask Yourself Before You Sign on the dotted line.
1. Do I really need this item right now or can I wait?
2. Can I qualify for credit?
3. What is the interest rate (APR)?
4. Are there additional fees?
5. How much is the monthly payment?
6. Can I afford to pay the monthly payments?
7. What will happen if I don’t make the payments on time?
8. What will be the extra cost of late payments?
9. What will I have to give up to pay for it? (Opportunity cost)
10. All things considered, is using credit worth it?

Rights and Responsibilities

When you sign the application for a loan or a credit card, you are legally obligated to uphold what’s written in the agreement. That means you agree to repay a loan and interest on time. These are your personal financial responsibilities. If you fail to keep your part of the bargain, lenders may take legal action against you to recover what you can. As a consumer, you have certain legal rights that lenders must respect. For instance, by law, lenders must put in writing the total cost of using their credit. They must also be truthful in their advertisements. With certain types of credit, you are legally allowed to cancel a credit agreement with a lender within three days—assuming you haven’t used the money borrowed. With credit cards, your responsibility to pay is limited to $50 if someone uses your card without your permission, for example, if it is stolen.

Under Excessive Debt

Getting out of under excessive debt is a lot harder than getting into debt, but the rules are simple. In fact, there’s only one: spend less than you earn! Applying it, however, is not always easy. You have to delay gratification today to clean up yesterday’s mess.

This is one place where your budget comes in handy. If you consistently spend less than you earn, you can use the additional money to pay off your debt. If you have several loans, try to make the minimum required payments on all of them. If you can’t, always try to send at least some money to all of your lenders. Talk with them, and let them know you are doing what you can to pay them back.

If there’s money left after you’ve made your minimum payments, use it to begin paying off one of your loans at a time. Start with the loan with the highest interest rate—not the loan with the largest balance. You want to pay down the high-interest-rate loans first, because you know how compounding can work against you!

When that loan is paid off, apply the money to the loan with the next-highest interest rate. Keep the process going until your overall debt is back under control. So remember, if you find yourself drowning in debt—focus on your budget, spend less than you earn, and begin to pay off your consumer loans.

If you find yourself unable to manage your debt problems, it could be helpful for you to seek the services of a nonprofit credit counselor to help you in creating a debt recovery plan—and sticking to it.

Bankruptcy

Sometimes debt can overwhelm responsible people. Illness, divorce, business losses, and being one step behind in your child support can bring borrowers to the point at which they can no longer make loan payments. This can be a cause for further behind in compounding interest on their debt grows. As a last resort, they have to consider bankruptcy.

Bankruptcy is a legal process that allows someone deeply in debt to create a plan to get out of it. Unfortunately, in 2000, about 1.2 million Americans filed for bankruptcy. Many of these bankruptcies were the result of unforeseen and unavoidable misfortune. For these people bankruptcy provides a “clean slate” and a chance to rebuild their lives. But for many others, bankruptcies were the actions of irresponsible borrowers who simply decided to default on their obligations. Because of the growing incidence of bankruptcy abuse, Congress is considering changes in the law.

Chapter 7 bankruptcy allows you to effectively erase most of your debt. To qualify, you typically must be unemployed or have a very low income. In addition, you must go through financial counseling as part of the process.

Chapter 13 bankruptcy allows you to pay back some of your debts, but with more time. A court typically oversees the repayment plan to ensure accountability.

Bankruptcy is very costly to everyone involved, including:

• Lenders, who must absorb losses they can’t recover by raising rates on other loans and services.
• Responsible borrowers, who must pay higher rates to help lenders recover losses on bad loans.
• People who’ve declared bankruptcy, whose actions remain on their credit records for up to 10 years, and who might find it harder and more expensive to borrow from wary lenders in the future.

Assignment 5.3

A Plan to Get Out of Debt

Using the credit information below, prioritize the order of the debts to be paid.

1. a. car loan with a balance of $6,000, monthly payments of $250, and an interest rate of 8%.
2. b. bank credit card with a balance of $800, minimum monthly payments of $20, and an interest rate of 15%.
3. c. student loan with a balance of $30,000, monthly payments of $175, and an interest rate of 7%.
4. d. credit union credit card with a balance of $2,300, minimum monthly payments of $70, and an interest rate of 5.9%.

Assumption: All loans will be paid at their minimum rate.
You're healthy, young, vivacious, and happy. Why in the world would you need insurance? You know the guy who was hit while riding his motorcycle or the girl who broke her leg playing soccer? I bet they (or their parents) had to make a call to their local insurance agent to handle the piles of paperwork that go along with, you guessed it, Accidents! Accidents, along with most everything else, have a cost. Not surprisingly, the more catastrophic the event, the more it costs. Are you convinced? If not, you may want to consider the information on the next page and think about how some of these statistics apply to your life.

Could you afford to pay for the damages you caused in a car wreck? What if you had to fork out five grand to repair damages from a hit-and-run or even a minor fender bender? How can you be a smart insurance shopper?

Overview:
Risk Management

Risk is the chance that something unexpected will occur. Risk management means that you use various ways to deal with potential personal or financial loss. You have basically three options in how you handle personal or financial risk.

First, you can avoid risk altogether. To avoid the chance of being injured in a plane crash, you could take the train. To avoid the risk of being hurt in a car accident, you could walk or ride your bike to school. Some of these options are more practical than others. If you live 20 miles from school, walking or riding a bike to school each day is probably not realistic. But if it’s important to you to avoid a certain risk altogether, it can be done.

Most people prefer a more practical approach to handling risk, which leads to the second option, minimizing (reducing) risk. If you must travel in a car, wear a seatbelt. If you’re the driver, you learn to drive defensively. You could drive a heavier car with safety features, like airbags, instead of a smaller, lighter car. You’re still taking the chance of being involved in an auto accident, but you are lowering the risk of being seriously hurt.

The third option in handling risk is to pass it on (transfer) to someone else. That’s where insurance companies come in, and many people choose this approach to help them manage their big financial risks. In effect, consumers trade small, predictable losses in exchange for the promise of help with big, unknown financial losses. To understand how this works, you need to know some insurance basics.

Insurance Basics

Insurance is protection against large-scale financial loss. In exchange for a relatively small payment, which is the premium, you’re protected against the chance of a big financial setback, a large loss.

“In exchange for a relatively small payment, which is the premium, you’re protected against the chance of a big financial setback, a large loss.”

Keeping Your Costs Down

“Small payment” is a relative term. Auto insurance for teenagers, for instance, can run several hundred or even thousands of dollars per year. This stuff’s not cheap, but there are strategies to help you lower your premium costs.

Every insurance policy has a coverage limit. The coverage limit is the maximum amount the insurance company will pay in the event of a claim. Coverage amounts can be just a few thousand dollars, or a few million. As you might expect, the more coverage you want, the higher the premium.

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Should you drop collision? If you're driving an older vehicle, you might be able to lower your insurance premium by eliminating the collision coverage on your car. You can do a simple analysis by comparing the cost of collision, which is listed as a line item on your auto policy, and the size of your deductible to the market value of your car. For example, assume you drive a car that's worth $1,000, and your insurance policy has a $500 deductible, and collision coverage costs you $100 per year. If you have an accident that total your car, you'd get a check for a maximum of $500 from the insurance company. In effect, you're paying $100 per year to get a one-time payment of $500 in case of a drastic accident. Is that a good benefit for the cost? Probably not, but the answer really depends on your circumstances and your choices.

Shopping for Auto Policies You can buy auto insurance coverage through several different sources. The traditional way is to meet with an insurance agent, who can explain how the policy works and what it does and doesn't cover. Another option is to obtain coverage over the phone, usually by calling a toll-free number. A relatively new choice is buying coverage through several different variables that can raise or lower your premium. $250, $500 or $1,000. In addition to the deductible, there are some additional variables that can raise or lower your premium.

Comparison of the Cost of Automobile Insurance

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How Well Are You Covered? Using the chart below for one car, fill in the coverage amounts for yourself. If you drive, or for an adult family member if you don't drive. You can find all of this information on the auto insurance policy. Then contact at least two more insurance companies to find out what they would charge for the same coverage. You can also use this chart to shop around if you want to increase coverage for different categories.

Assignment 6.1

How Well Are You Covered? Using the chart below for one car, fill in the coverage amounts for yourself. If you drive, or for an adult family member if you don't drive. You can find all of this information on the auto insurance policy. Then contact at least two more insurance companies to find out what they would charge for the same coverage. You can also use this chart to shop around if you want to increase coverage for different categories.

Assignment 6.1

Health Insurance

Health insurance pays the medical bills in case you, or your family members, become sick or injured. Routine medical expenses easily cost hundreds of dollars, and more serious problems can cost thousands of dollars. Health insurance is an employee benefit that is a must-have. Most health insurance plans will cover you as a ‘dependent’ of an adult family member until you reach age 19. At that point, you need to find your own coverage. It’s usually cheaper if you can join a “group policy,” which is what many employers offer their employees. You can, however, purchase an individual policy for yourself or your family, but usually at a much greater cost than a group policy. By the way, if you’re going to college, many policies will continue to cover you as long as you’re a full-time student, up to age 23. At that point, you’re off the adult family member’s health insurance policy and on your own.

Property Insurance

Property insurance protects your material possessions—your home and its contents. Most health insurance plans cover damage to your own home or to its contents, but not your neighbor’s. If you have a mortgage, your lender probably requires a certain level of coverage, usually at least 80% of the property’s value.

Future Insurance Needs

As you get older, your life will change in many ways. You may switch jobs or careers. You may get married and start a family. You may acquire vast amounts of wealth, or live simply and get by with just enough to stay happy. Whatever your situation, you’ll probably need some additional kinds of insurance protection.
stuff—such as clothes, a stereo, a TV, appliances, furniture, a bike, computer equipment and so forth. Your material goods can be damaged in a variety of ways, including fire, flood or theft.

When you own a home, home-owners insurance also protects the house itself against damage from these problems. What if you’re a renter? You can still protect your possessions with a renter’s policy. It only covers your goods and not the building you rent. Usually a landlord will have insurance that protects the physical structure of an apartment, but not the renter’s goods inside it.

Life Insurance
Life insurance protects people who depend on you financially in the event of your untimely death. While you are single and no one is dependent on you, you probably don’t need life insurance. If you marry, and your spouse works and could get by financially without you, you still may not need life insurance. But anytime someone else depends on your income to help pay the bills, you need life insurance. For example, assume you are married and have children. If you die unexpectedly, your children will have financial needs, such as paying for food and clothing. Perhaps you’re single but provide financial support to an adult family member. If you pass away, that family member will still have financial needs in the future.

Life insurance comes in two basic forms. “Term” life insurance offers pure protection, while “whole life” offers protection and builds up a savings account. Term is more affordable and will often meet your life insurance needs quite well for a period of many years, especially as a young person.

Disability Insurance
Disability insurance essentially pays your income from a job if you are sick or physically unable to work for long periods of time. If you have an extended leave of absence from work, employers generally don’t pay you, regardless of your reason for being out. In the meantime, you still have living expenses, like food, gas, utilities and rent. How do you pay those bills if you can’t work?

That’s when disability insurance comes in. This insurance typically pays you 60% to 70% of your full-time wage. The insurance companies don’t pay 100%, because then there would be no financial incentive to go back to work.

There are two main types of disability insurance. Short-term disability covers you for periods of up to two years. Long-term disability typically covers you for periods of one year all the way up to retirement, which could be decades.

You’re statistically more likely to need disability insurance during your working life than life insurance to cover your unexpected death. Many employers offer disability as an employee benefit, and it is worthwhile to sign up for it if you can.

Liability Insurance
We mentioned earlier in the auto insurance section that liability coverage protects you in case of a lawsuit related to an auto accident. But you can also be sued in other circumstances. That’s when liability insurance protects you from costly legal fees and multi-thousand dollar settlements in court cases.

Most insurers offer liability insurance as an enhancement of coverage for a homeowner’s policy, called an “umbrella” policy. An umbrella policy is designed to protect you in almost all areas of your life. It provides additional liability coverage for a homeowner’s policy and may also cover auto policies.

When do you need an umbrella policy? In general, if you own a house and drive a car, you should have an umbrella policy. Coverage of this type is very cheap; a policy with a $1 million limit might cost about $200 per year. That’s a lot of coverage for your dollar.

Your Insurance Plan
By now, you should have a broad overview of the types of insurance available to you, as well as what kind of protection each type of policy offers. Many of these policies may not be of use to you until your circumstances change, such as getting married and starting a family. But you at least know what to look for when the need arises.

Oftentimes the cheapest place to get insurance coverage is through an employer. So when you’re in the job market, it pays to think ahead and look at all the benefits an employer offers, including insurance coverage for potential future needs.

Action Steps
“The Car of Your Dreams”

Using the Internet, shop for the car of your dreams. Find the exact make, model, year, and features you really want. Once you have that information, use the Internet to find out how much it costs to insure the car of your dreams. Keep an eye out for ways to lower your insurance costs.

Does the engine size make a difference in the premium? What about safety features? What cost difference does a clean driving record make compared to one with tickets and/or accidents? What happens to the premium if you choose the exact same car but it’s one year older?
Understanding Checkbook & Megabyte Money

The material below and on the following page has been provided by GE Consumer Finance and is not part of the NEFE High School Financial Planning Program.

Get Smart About Smarter Money

The technological revolution in electronics and telecommunications that brings you television coverage of a rock concert in Europe, notebook computers and car phones, has transformed the fundamental nature of the tool called money. Long ago, our ancestors used wampum, feathers, or hides as money. Minted coins and paper currency made money a more convenient medium of exchange by allowing it to be standardized into units of value. Then checkbook money made payments safer and easier. And now "megabyte money" (literally money in the form of the 1's and 0's of computer code) allows us to move money instantly along electronic highways.

Because it will play such an important role in your life, it pays you to become smart about smarter forms of money. If you want to know how to take advantage of a checking account or benefit from the 24-hour banking convenience of an automated teller machine (ATM), read on.

The Value of Money

Where hides as a form of money had a value as clothing and bedding, most modern money has little intrinsic, or "commodity," value. Aside from their value as money, $20 bills are just pieces of paper, and balances in checking accounts at financial institutions are just entries in the memories of their computers.

Money’s real value is measured by its purchasing power — by the quantities of goods and services that money can buy. When the prices of goods and services rise, a given amount of money buys less, so the value of money declines. When prices fall, the value of money increases. Thus money’s value, or purchasing power, is inversely related to (moves opposite to) the general level of prices in an economy.

Checkbook Money

Earlier we said that checkbook money made payments safer and easier. Here’s how it works. You put money into an account at a financial institution for safekeeping. When you want to purchase something, you write instructions to the institution to pay a specific amount of your money to a specific person, company or government. Your written order is called a check. A check acts like cash because it represents the money in your account. You can use a check to pay your bills, the same way you use cash. If you haven’t done so already, it is time to consider replacing your cash economy with a checkwriting account.

Here’s how you benefit:

- **Safety.** You and your money are much safer when you carry checks instead of cash. If your checks are lost or stolen, just notify your financial institution immediately. You will not lose your money.
- **Convenience.** You have all the money in your account available every time you write a check; you are not limited to the cash in your pocket. A check makes it easy to pay bills and send money by mail. And a check is less expensive and more convenient than a money order.
- **Good Records.** A checking account has a built-in record keeping system. Your check register shows where your money comes from and where it goes.

Megabyte Money

Our ability to use "electrons in motion" in place of currency and checks is having as dramatic an effect on our society as did the shift from barter to the use of currency. It is revolutionizing our system of payments. Economist and New York Times editor Joel Kurtzman has coined megabyte money to describe this newest medium of exchange. Kurtzman argues that megabyte money is different from checks in that the technology has preceded it—and from the money jingling in your pocket or purse.

It is digital money in a global electronic system that links tens of thousands of computers in place as lofty as the Federal Reserve and the Tokyo Stock Exchange and as lowly as the automated gasoline pump that accepts credit and debit cards.

Here’s how you can benefit from this technological revolution. Let’s say you have a savings account and want to take some of your money out, but it is Saturday afternoon and your financial institution is closed. No problem. Just locate an automated teller machine (ATM) and use your ATM transaction card to withdraw cash. Now imagine you are traveling in a different state and you need cash. There’s still no problem. By using an ATM that is linked by one of several networks to your ATM at home, you can get money from your account 24 hours a day.

Another way to take advantage of this revolution is with a debit card, which acts like an electronic check. (In fact, you must have a checking account to get a debit card.) It allows you to make payments through a point of sale (POS) terminal, which is just a fancy name for a card reading computer device. When you make a purchase with a debit card, your money moves instantaneously from your checking account to the merchant’s. With increasing frequency, you will begin to see POS terminals in grocery stores, gas stations and retail shops as this form of payment becomes more popular.

Debit cards and automated teller machines are examples of modern technology called electronic funds transfer systems (EFT). EFT makes payments between parties by substituting an electronic signal for cash or checks. You can use EFT to make regular, recurring payments. You can authorize your financial institution to make automatic, electronic payments directly from your checking or savings account for monthly car payments or savings deposits, for example. In fact, automated savings is one of the easiest ways to save.

Here’s How to Use an ATM

Without doubt, ATM’s are the most visible manifestation of EFT. These computerized systems allow you to take care of 90% of your banking needs, 24 hours a day, without ever setting foot in a financial institution.

You can get cash, make deposits, pay bills, transfer funds from one account to another and check your account balance electronically. Make sure you avoid the temptation to wash your hands after using this convenient access to cash. On some machines, you can make loan payments, pay certain utility bills, and send messages. Here’s how to use an ATM.

In order to use an ATM, you must have a card and a Personal Identification Number (PIN). Without your PIN, the machine won’t work. Memorize your PIN for safety. Do not keep it with your card.

When you are ready to use the ATM, first record the transaction in your register and carefully follow these steps:

- Insert your card in the slot provided.

On the number keyboard, punch in each digit of your PIN number firmly and separately. If you make a mistake, press the “cancel” button and start again.

The television-like screen will display instructions, so you want to withdraw money from your account, make a deposit, transfer money from your checking account to your savings account or check your account balance. Select the activity by pressing the button that indicates the transaction you desire.

On the number keyboard, enter the exact amount of cash withdrawal, deposit, money transfer, or payment. Enter amounts in dollars and cents: $20.00 should be entered as $20.00. If you make a mistake, press the “cancel” button and start again.

If you are making a deposit, you should place your transaction in an envelope before beginning the process. You will find envelopes for this purpose adjacent to the ATM machine. Write the dollar amount on the outside of the envelope so that you will not forget the exact figure when operating the ATM.

When you are ready, select the “make a deposit” option. Then follow the instructions on the screen and insert the envelope into the slot at the appropriate time. If you would like to make a payment, follow the same instructions as for making a deposit.

After the first transaction, you have the choice of entering another one. If you want to do business at the ATM, simply press the appropriate buttons. When you have finished your transaction, take the options. Do your card back. Save the receipt until you have received your account statement in case there are any discrepancies. In all cases, a receipt covering your transactions will appear and your card will be returned to you.

Play It Smart

Follow these rules for extra protection and efficient management of your ATM account.

Choose your PIN carefully. (some PINs are assigned) Select
a code that would be hard for someone to guess. Do not choose your name or initials, phone number of birth date.

Learn how to keep a secret. Do not share your PIN. Always keep it separate from your access card for security. Never write your code number on your card, and don’t keep your card and code together in your wallet. A card without the code won’t do a thief any good.

Watch out for prying eyes. If anyone is standing too close when you use the ATM, ask the person to move. If you can’t avoid a watcher, go to another machine or use your hand to shield the keys so no one can see what number you use.

Always wait to collect your card and a receipt, no matter how rushed you are. You’ll need the receipt to check your monthly statement.

If there is a mistake, call the financial institution immediately.

Record the transaction in your check register or savings record book as it is made. Don’t wait, you may forget to record it later.

Keep Your Balance While Writing Checks

People who are earning and saving money to reach a financial goal, find that a checking account makes this job easier. Checking accounts were invented because they offer an excellent means of handling money, making payments and keeping records. In fact, checking accounts are so universally popular that the Federal Reserve issues 2 billion checks every night as financial institutions settle their accounts with each other through the clearing house system. If you want to take advantage of the safety and convenience of a checking account, read on.

How to Choose the Right Checking Account

Checking accounts come in a wide variety of types and styles. There are accounts that pay interest on the money on deposit, and those that do not. Some are priced by the number of checks written and deposits made, and some are even free of charge. You can open an account that is loaded with features, or one considered “plain vanilla.” You can open an account by yourself or jointly with others. The best for you is the one that costs the least for the services you need. The fee (if any) for checking services is determined by your average account balance (the amount of money you keep in your account), and by how many checks you write each month. It is easy to open a checking account. Here are the steps:

- **Introduce** yourself to the new accounts officer, and discuss how you plan to use the account. They will help you choose the type of account that best suits your needs.

- They will also help you complete the checking account agreement form. For your protection, you will be asked for current identification.

- **Sign** the signature card. Your signature is a key to account security. Your signature on your checks must match the signature on the card.

- **Choose** the style checks you want, and the color and pattern on the checks from the catalog they will show you. Pick the one you like best.

- **Make** your first deposit. Most financial institutions require a minimum balance of $100 to open a basic account.

You will receive a starter checkbook so you can begin using your account right away. Checks in the style and pattern you chose, and personalized with your name and address, will be mailed to you.

Follow these important pointers whenever you use your checking account:

- Good record keeping is the key to no-hassle checking. Before you write a check or make a deposit, fill out your check register completely. Always describe the source or use of your money.

- Keep your balance up-to-date to prevent spending more than you have available. "Bounced" checks will cost you steep fines and harm your financial reputation.

- **Before you use an automated teller machine (ATM), record the transaction in your register.**

- **Always** write clearly, using permanent ink, so the financial institution understands what you want it to do.

- **Write** the amount in words beginning as far left as possible. Do not use the word "and." Draw a horizontal line to fill up any empty space so no one can add to your instructions. The amount written in words must match the amount written in numbers.

- Do not sign the check until you are sure the information is correct and complete. Then use the same signature that you signed on the signature card.

- Always note the purpose of the check for good record keeping.

- Your account number is printed in a magnetic ink to help the bank separate your checks and deposits slips from others. If these numbers are torn or soiled, tear up the document and write a new one.

- Use a deposit ticket to tell the bank to add money to your account.

How to Endorse a Check and Make a Deposit

A check is an easy way for you to make payments. But what do you do when someone pays you with a check? You can cash it, give it to someone else, or put it into your account. This section shows you how.

All checks go back to the financial institution eventually. This is why you must add your signature and any instructions to the back of a check, telling them what you want done with your money. Called an endorsement, this is your signed approval for a check to be cashed (turned into cash), deposited (added to your account) or assigned (paid to someone else). Place your endorsement within one and a half inches of the top of the back side of the check (opposite side of where “pay to order of” is printed).

Use the blank endorsement shown (your signature and account number) when you want to cash the check. Be careful. A blank endorsement allows anyone else to cash it if it is lost or stolen. Use the restrictive endorsement if you want to make sure your check can be deposited only into your account. Write “for deposit only” above (or below) your signature or account number. Use the special endorsement if you want to give your check to someone else. Write “pay to the order of” and the person’s name, then sign your name underneath.

It is very important to keep good records. Instead of cashing a check or assigning it to someone, deposit it and then write a check from your account. This two step process is the best way to keep track of where money comes from and where it goes.

Use a deposit ticket to tell the bank to add money to your account. They are found behind your check in your checkbook. To fill out the deposit ticket, begin by writing the date in the space provided.

If you have paper money (currency) and coins, enter the amount on the line labeled “cash.” If you are depositing checks, list their amounts one to a line in the blocks provided. Total the amount of your deposit and enter the sum on the “total” line. When you are ready, give your deposit slip, cash and/or endorsed checks to the teller who will give you a receipt. Keep the receipt for your records.
For more than 120 years, GE has been committed to being a respected corporate citizen, leading change in our business and our communities. We have a long tradition of supporting diverse communities where our employees live and work, and we use our resources, time and talent to make sustainable changes in local communities and around the globe.

Throughout GE Consumer Finance, our volunteers serve as mentors to children and their parents in providing financial education. We are driven by the knowledge that quality education promotes a lifetime of opportunities and we focus our efforts primarily on children, education and economic development. Through our programs, we’re helping families set goals and budgets, manage their finances, and better understand credit.

By supporting financial education programs, we’re helping students and their parents realize their financial goals.

We are helping to educate tomorrow’s workforce.